

Testimony of the
American **Bankers** Association

Submitted for the record

before the

Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
of the
Committee on Financial Services
United States House of Representatives

Regarding Legislative Proposals on Government Sponsored Enterprise Reform

March 12, 2007

The American Bankers Association is pleased to submit testimony for the record regarding legislative proposals on Government Sponsored Enterprise (GSE) reform. The ABA, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of our industry. Its membership - which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks - makes ABA the largest banking trade association in the country.

Our Association has long supported reforming the regulation of Fannie Mae, Freddie Mac and the Federal Home Loan Banks. We were strong supporters of legislation passed on a bipartisan basis by this Committee and the House of Representatives in the last Congress. We appreciate the efforts of this subcommittee and the Financial Services Committee to again address the need to create a strong, reliable, and coherent supervisory structure for

these GSEs. This testimony will address the financial implications of GSE reform for the banking industry and the need for a new regulatory structure. The ABA has developed a number of principles relating to GSE reform that we would like to share with you. In addition to these principles, we shall also address some specific policy issues that have arisen with regard to ongoing reform efforts.

Financial Implications for the Banking Industry

Fannie Mae, Freddie Mac and the Federal Home Loan Banks combined have approximately \$2.6 trillion in debt. This compares to \$5.4 trillion in total corporate debt in the U.S. economy and approximately \$4.3 trillion in Treasury debt. The banking industry holds a significant amount of GSE debt. Combined GSE debt and GSE-sponsored mortgage backed securities (MBS) held by the banking industry represent 11.26 percent of total assets of the industry. Significantly, combined GSE debt held by the banking industry equals 141 percent of the tier one capital held by the entire industry: because GSE debt represents such a large component of the nation's economy, and such a large portion of bank holdings, strong, reliable and coherent supervision of the GSEs is vital.

Principles on GSE Reform

ABA has developed the following principles which we believe should guide any reform of GSE regulation:

- Any new GSE regulatory agency should be an independent agency within the Treasury Department. The agency should be modeled on other Treasury regulatory agencies, and should not be reliant upon the appropriations process for funding.
- Any new agency with oversight of Fannie Mae and Freddie Mac should have authority to regulate mission adherence, product approval, and safety and soundness of these enterprises. Establishment and review of specialized affordable housing goals should be done in consultation with the Department of Housing and Urban Development.
- The new agency should not impede the enterprises' access to the capital markets beyond the current authority of the Treasury Department to regulate "traffic flow" to the markets.
- Any new agency must take into consideration the considerable differences among the GSEs, and particularly with regard to the Federal Home Loan Banks, that there are significant differences between the FHLBs and Fannie and Freddie with regard to their missions, their lines of business, and the customers they serve. These differences must be reflected in the organizational structure and the regulatory agenda of the new agency.

Specific Policy Issues

Product Approval: It is vital that any legislation contain clear, unambiguous and sensible requirements for approval of products offered by the GSEs. Such language must ensure

that the GSEs remain secondary market providers and that they do not stray into the primary market through the development of new products or services. At the same time, it will be important that product approval procedures do not inhibit innovation or development of secondary market products that enhance and assist primary market participants and consumers. We recognize that there can be a very fine line between a primary and secondary market activity, and that evolving marketplaces can sometimes blur even that fine line. Therefore, we encourage the inclusion of language in any legislative proposal requiring, as a foundation for product approval, that any product must adhere strictly to the GSEs' charter limitations.

Capital: ABA has long advocated for bank-like regulation of the GSEs, particularly with regard to the required capital levels. We note that banks, on average, hold approximately six percent capital. Currently, the Federal Home Loan Banks hold approximately four percent capital and Fannie and Freddie hold approximately 2.5 percent (with an ongoing regulatory requirement that Fannie and Freddie each hold 30 percent additional capital above the 2.5 percent limit due to consent decrees entered into by each GSE). While differences in the percentage of capital held may be appropriate, depending upon the risks faced by differing entities, we maintain that the way the risks are determined and the levels that are set should be similar. Bank regulators are in the process of considering ways to improve the risk sensitivity of their capital rules, and we believe that a similar process should be undertaken for the GSEs. Although some have raised concerns about capital levels being used by a regulator to achieve policy goals other than those related to the safety, soundness and mission of the GSEs, we believe that a strong, respected regulator, like the banking regulators, would have strong institutional biases against using capital levels for other

purposes. Creating a strong, independent regulator with powers like those given to the bank regulators will help to ensure the proper actions by both the regulator and the regulated.

Mission: Our principles for reform include taking into consideration the differences among the GSEs. These differences include structure (Fannie and Freddie are publicly held corporations while the Federal Home Loan Banks are member-owned cooperatives), and differences in mission. While all three entities were created to serve the primary market, the Federal Home Loan Banks' mission is far different from that of Fannie Mae and Freddie Mac. Therefore, we strongly urge that the organizational structure of the new regulator take into account this difference in mission as well as the differences in structure and ownership. Additionally, we would note that the Federal Home Loan Banks' mission includes the funding of the Affordable Housing Program, a highly successful and innovative program that has provided billions of dollars in grant and other assistance to foster the development and preservation of affordable housing nationwide. Care must be taken to ensure that nothing is done either in legislation or through a new regulatory scheme to harm this successful program.

Farm Credit System: Finally, ABA urges the Committee to use this opportunity to review the regulatory oversight of a GSE which all too frequently escapes serious regulatory scrutiny – the Farm Credit System (FCS). The FCS is a multi-billion dollar entity whose regulator lacks the financial expertise of the Treasury Department. It is notable that the FCS is the only GSE which has required federal intervention to prevent a financial default. Clearly it is an entity that would benefit from a regulator with greater expertise and supervisory powers. We recognize that the FCS is not under the jurisdiction of the Financial

Services Committee, but we urge the committee to work with the Agriculture Committee to bring more appropriate regulatory oversight to this often overlooked GSE.

Conclusion

The ABA strongly supports efforts to reform the regulation of Fannie Mae, Freddie Mac and the Federal Home Loan Banks. We encourage the committee to incorporate our guiding principles relating to the structure, mission and powers of the new regulatory agency. We appreciate this opportunity to comment on reform proposals, and we will be pleased to work with the committee as the legislative process moves forward.